Supreme Court, U.S.
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No. 94-107

In The

Supreme Court of the United States

October Term, 1994

BRYAN VERCOE,

Petitioner,

vs.

FIRSTIER BANK, N.A., OMAHA, As Trustee of the Profit Sharing Plan and Employees Trust of Land Paving Company, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

REPLY BRIEF

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I.

THE PETITIONER REQUESTS THAT THIS COURT CONTACT THE UNITED STATES DEPARTMENT OF LABOR FOR THE PURPOSE OF REQUESTING THEIR VIEWS REGARDING THE ISSUES HEREIN.

As noted in a letter dated May 4, 1994, from Alexander Fernandez of the Plan Benefits Security Division, the Department of Labor is willing to review this matter if this Court requests their views. (App. 68) The issues herein involve issues of first impression for this Court regarding the doctrine of strict liability and attorney fee awards. They also involve the interpretation of Department of Labor regulations.

In this regard, FirsTier cites the Department of Labor regulations Section 2550.408b-1(a)(4)E(3) for the proposition that the trustee has no duty to investigate the purpose of a loan. (Respondents' Brief in Opposition, p.9) This example is easily distinguishable because it does not state whether the trustee should have known or had a conflict of interest. The preamble clearly states that a trustee must take actions "exclusively for the benefit of the participants" and requires "the absence of any inappropriate precondition or other facts and circumstances indicating that the loan program is not administered primarily for the benefit of the participants." (App. 64-65) Due to the significance of the issues and the possible misinterpretation of the Department of Labor's position, the Petitioner requests that this Court contact the Department of Labor for their views on the issues herein.

II.

FIRSTIER DID NOT DISPUTE ANY OF THE EVIDENCE ESTABLISHING A CONFLICT OF INTEREST.

The rules of this Court are clear that a petitioner is not limited to the findings of fact because the respondent is "admonished that they have an obligation to point out any perceived misstatements *in their brief of opposition.*" Sup. Crt. Rule 15.1 (emphasis in original).

The fact that the amounts borrowed from the Plan represented the maximum amount each participant could borrow is largely based on the testimony of Stanley Traub, FirsTier's trust officer, (App. 70-71), and other evidence admitted at trial. Additionally, the paragraph on page 20 deals specifically with the one 1984 loan that was outstanding. The reference to "all" loans were outstanding is in reference to the previously mentioned 1984 and 1987 loans that were outstanding at the time FirsTier filed its complaint. (App. 17) However, the most critical omission by the Eighth Circuit is their failure to conclude that a conflict of interest existed. Even FirsTier did not dispute this in their Brief and the undisputed facts establishing a conflict of interest bear repeating.

The trust officer for the Plan and his immediate supervisor testified at trial that they knew that FirsTier was a creditor of LPC and that LPC was in a precarious financial condition. The trust officer also testified that his immediate supervisor informed him that LPC was in danger of defaulting on its loan. They also testified that they had a meeting, several days prior to the transfers in question, with Anthony Dombrowski, LPC's president and the Plan Administrator. At this meeting, Dombrowski

requested a direct transfer of funds in the Plan to LPC in violation of ERISA, which they refused. Several days later, FirsTier received a document signed by Dombrowski as Plan Administrator requesting participant loans for four employees. The trust officer and his supervisor were aware of and approved these loans. The loan proceeds transferred from the Plan to the participants, to Dombrowski, and *then back to FirsTier on a loan LPC owed to FirsTier*. (App. 20) (emphasis added)

In its opinion, the Eighth Circuit did not specifically note that in the March 27 meeting, Dombrowski made a direct request to transfer plan assets to LPC or that the trust officer believed that LPC was in danger of defaulting on its loan to FirsTier. These critical facts were included in the Petitioner's writ and were not refuted by FirsTier in their brief. For the Court's convenience, the trust officer's testimony regarding these facts is included in the Appendix. (App. 70-74) Even if the foregoing omissions are excluded, the Eighth Circuit noted that the trust officer knew his bank was a creditor, knew of LPC's "heavy indebtedness and feared misuse of Plan assets." Clearly, this establishes, as a matter of law, a situation in which the trust officer's motives might conflict with the beneficiaries. Thus, the issue before this Court is the standard that should be followed if a trustee fails to avoid a conflict of interest.

The Eighth Circuit held that a conflict of interest did not exist because a conflict is only created if "the bank has been influenced by a desire to promote its own interest." (App. 49 footnote 6). However, the authority cited from *Scott on Trusts* is taken completely out of context because it is included in a section that discusses the duty

of loyalty and bank trustees are not noted as exceptions to the strict liability rules. (See, IIA *Scott on Trusts*, Section 170.25.)

The underlying purpose for the strict liability doctrine has been stated most eloquently by Judge Cardozo:

> "many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."
>
> *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928)

This principle was recognized by the Eleventh Circuit in *Brown v. Blue Cross and Blue Shield of Alabama*, 898 F.2d 1556 (11th Cir. 1990). For this reason, it held that the beneficiary need not show that a trustee: acted in bad faith, gained an advantage or the beneficiary was even harmed because the law presumes the fiduciary acted disloyally. *Id.* at 1565.

Under common law, the only exception to the strict liability standard was that the conflict was too remote or too feeble. Congress specifically subjected a trustee involved in a plan participant loan to Section 404 of

ERISA. (App. 65) Therefore, it did not consider an indirect transfer to a party at interest as too remote. Furthermore, FirsTier received both an indirect and a direct benefit when the loan proceeds were used by LPC to pay a portion of its debt. Therefore, there is a clear causal nexus between the loans in question and the conflict. Finally, Ninety-Three Thousand Nine Hundred Fifty Dollars ($93,950) is not a feeble amount.

FirsTier contends that the Petitioner did not prove intent or that FirsTier knew it would receive a benefit from the transfers. Pursuant to *Brown* and common law, these findings are totally irrelevant because they involve the subjective intent of the trustee. Common law clearly recognized that it would be virtually impossible for a court to determine subjective intent. For this reason, it struck down *all* transactions once the conflict was established. See *Fulton National Bank v. Tate*, 363 F.2d 562 (5th Cir. 1966) (emphasis added). Additionally, the Petitioner has never alleged that there is a per se conflict of interest if the bank is a creditor and a trustee. The Petitioner simply states that this case is clearly distinguishable due to the trustee's knowledge. Additionally, FirsTier's reliance on *Ershick v. United Missouri Bank*, 948 F.2d 660 (10th Cir. 1991) is also misplaced. The trustee in *Ershick* was subject to the directions regarding investment activities. ERISA specifically permits a trustee to be directed regarding investment activities, but not trustee responsibilities. (See ERISA Sections 405(c)(1) and (3), 29 U.S.C. Sections 1105(c)(1) and (3) and discussion in Part IV, infra.)

Common law developed the strict liability standard because there is no greater threat to the fiduciary relationship than a trustee that acts with dual loyalties. IIA *Scott on Trusts*, Section 170, p. 311 and *G. Bogert & G. Bogert, Law of Trusts and Trustees*, Section 543, p.217 (2nd Rev.Ed.1982) However, the trial court inexplicably failed to incorporate it in their decisions. If a court can be so callous as to ignore a clear conflict of interest which was established solely upon admissions against interest on behalf of the trustee in a transaction in which the trustee receives the ultimate benefit, ERISA's high standard of fiduciary care simply is meaningless. It is only a matter of time before ERISA is at a level "trodden by the crowd" and the abuses of the past will quickly re-emerge.

III.

A UNIFORM RATIONAL METHOD OF AWARDING ATTORNEY FEES MUST BE ESTABLISHED.

FirsTier alleges that the Petitioner has attempted to mislead this Court in the interpretation of *Leigh v. Engle*, 858 F.2d 361 (7th Cir. 1988). For the sake of brevity, the Petitioner simply notes that in the first trial, the trial court had awarded a defendant bank attorney fees for successfully defending itself in an ERISA lawsuit. *Leigh v. Engle*, 727 F.2d 113 (1984). The Seventh Circuit reversed this award because:

> "courts have developed standards for the exercise of their discretion in awarding attorneys' fees under ERISA (citing the five factor formula). The district court made no findings and apparently undertook no analysis that would justify an award of attorney fees." *Id.* at 139.

In the case at hand, the lower court similarly made no findings and undertook no analysis when it made its attorney fee award. This is absolutely critical. Two circuit courts have held that it is abuse of discretion as a matter of law for a trial court to award a prevailing defendant an attorney fee without applying the five factor test. *Franklin v. Thornton*, 983 F.2d 939 (9th Cir. 1993) and *Quesenberry v. Life Ins. Co. of North America*, 987 F.2d 1017 (4th Cir. 1993) Therefore, assuming arguendo that FirsTier's analysis of *Leigh II* is correct, it only accentuates the split in the circuits.

This case readily demonstrates the need of a rational basis for awarding fees. In *Pilot Life Ins. v. Dedeaux*, 481 U.S. 41, 107 S.Ct. 1549, 95 L.Ed.2d 39 (1987), this Court invited the lower courts to develop common law rights and duties under ERISA. Based upon this invitation, the Petitioner brought a case predicated, in part, upon the common law doctrine of strict liability if a trustee failed to avoid a conflict of interest. This Court has never ruled whether this doctrine applies in ERISA. However, interpreting the language of Section 404 of ERISA to require a trustee "avoid conflicts of interest," it strongly has suggested that this doctrine applies. But to award a prevailing trustee their entire fee request without explanation when the basis of the participants' suit is predicated upon universally accepted common law principles, is simply a basic due process violation. It is even more egregious when the prevailing trustee is awarded fees for alleging positions that were erroneous as a matter of law. FirsTier contends that this was necessary because of its "original application to the court." (Respondents' Brief p. 18). If this is true, one wonders why the Eighth Circuit found it

necessary to reject this contention with special emphasis in its opinion. ("FirsTier argues that it had *no* fiduciary duty . . . ") (App. 43) (emphasis in original). Yet, the Eighth Circuit awarded FirsTier fees for a position that was erroneous as a matter of law. Intervention of this Court is necessary to preserve the enforcement scheme of ERISA.

IV.

FIRSTIER CANNOT BE A DIRECTED TRUSTEE AS A MATTER OF LAW.

In their brief, FirsTier alleges that they were a "directed" trustee pursuant to Section 403(a) of ERISA (29 U.S.C. Section 1103(a)). This authority is clearly distinguishable because it either applies to investment committees (see ERISA Section 403(a)(1) 29 U.S.C. Section 1103(a)(1)) or is expressly conditioned by Section 405(c)(1) (29 U.S.C. Section 405(c)(1)) which specifically prohibits a trustee from allocating trustee responsibilities. Section 405(c)(3) (29 U.S.C. Section 1105(c)(3)) of ERISA defines trustee responsibilities to include the duty to manage and control the assets of the plan and the Department of Labor has stated that the administration of a participant loan program is the management of plan assets. (App. 65) Accordingly, a trustee involved in a participant loan program cannot be "directed" as a matter of law, otherwise they have allocated their responsibility.

The Eighth Circuit agreed that the trustee involved in a plan participant loan is subject to Section 404 of ERISA. (App. 45) Their ruling, though, held that, due to the fact the Petitioner requested the transfer and the judge ruled

the employees were not coerced, it would not determine whether FirsTier should have known of the indirect transfer. Therefore, FirsTier did not breach its duty.

The inherent fallacy in this position is that this suit is based upon a breach of the fiduciary's duties. Obviously, any plan participant must request a participant loan. If a court may use this request to modify or alleviate the fiduciary from their duty, a sliding scale of fiduciary conduct will develop and soon portions of ERISA will be at a level "trodden by the crowd." For this very reason, common law held that the mere fact that a beneficiary requests an act, did not constitute consent. *Restatement (Second) of Trusts,* Section 216 Comment a (1959).

Furthermore, FirsTier did not refute in any manner the Petitioner's statement that when Anthony Dombrowski requested the loans in question, that he informed the Petitioner that LPC would cease operations if the loans were not made. Pursuant to Section 8(a)(1) (29 U.S.C. § 158(a)(1)) of the Labor Management Relations Act, this type of statement is coercion as a matter of law; and it should be pursuant to ERISA, as well. Assuming arguendo that this Court rules the employees were not coerced, coercion was simply just one of the elements of consent. *Restatement (Second) of Trusts,* Section 216(2) (1959). This Section requires a fiduciary to inform the beneficiary of all of the information he knows or should know and to inform him of his rights. *Id.*, comment k. More importantly, the fiduciary has the burden of proof on these issues, *G. Bogert & G. Bogert, Law of Trust and Trustees,* Section 941 p. 457 (2nd Rev. Ed. 1982), and the record is completely devoid as to whether FirsTier fulfilled this obligation. In the case at hand, it would be

difficult to imagine a more egregious fact pattern indicating that an indirect transfer to a party at interest, that the trustee knew was in serious financial difficulty. Accordingly, if ERISA is truly a statute to protect employees' rights, then it is axiomatic that a beneficiary must be fully informed of these rights and the information the trustee knows or should know before they can consent.

Accordingly, the Eighth Circuit's refusal to determine whether the trustee should have known of the transfers because of the trial court's coercion finding is erroneous as a matter of law because the required elements of consent are not in the record. Furthermore, FirsTier merely processed the loans and, therefore, never fulfilled its obligation. As the Second Circuit held: "[c]ourts do not take kindly to arguments by fiduciaries who have breached their obligations that, if they had not done this, everything would have been the same." *In Re Beck Ind., Inc.*, 605 F.2d 624, 636 (2nd Cir. 1979). This Court should adopt the identical view.

Respectfully submitted,

James E. Bachman #16194
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Omaha, Nebraska 68114-3318
(402) 390-0900
Counsel of Record for Petitioner

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§ 403. Establishment of trust

(a) Benefit plan assets to be held in trust; authority of trustees. Except as provided in subsection (b), all assets of an employee benefit plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument described in section 402(a) [29 USCS § 1102(a)] or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that –

(1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 402(c)(3) [28 USCS § 1102(c)(3)].

* * *

§ 405. Liability for breach by co-fiduciary

* * *

(c) **Allocation of fiduciary responsibility; designated persons to carry out fiduciary responsibilities.** (1) The instrument under which a plan is maintained may expressly provide for procedures (A) for allocating fiduciary responsibilities (other than trustee responsibilities) among named fiduciaries, and (B) for named fiduciaries to designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan.

* * *

(3) For purposes of this subsection, the term "trustee responsibility" means any responsibility provided in the plan's trust instrument (if any) to manage or control the assets of the plan, other than a power under the trust instrument of a named fiduciary to appoint an investment manager in accordance with section 402(c)(3) [29 USCS § 1102(c)(3)].

U.S. Department of Labor Office of the Solicitor
Washington, D.C. 20210
(SEAL)

VIA FEDERAL EXPRESS No. 8983473800

May 4, 1994

James E. Bachman, Esq.
9202 West Dodge Road
Suite 302
Omaha, Nebraska 68154-4409

Re: FirsTier v. Land Paving, et al.

Dear James:

I am writing to inform you that the Department of Labor is not able to assist your clients in the filing of a writ of certiorari before the United States Supreme Court in the above referenced case.

The Office of the Solicitor General permits U.S. Government Agencies to file amicus briefs before the Supreme Court only if the Court specifically asks for the U.S. Government's views. If you do file the writ of certiorari and the Court asks for our input, we would be happy to revisit the issue at that time.

We appreciate the time you have invested in communicating your thoughts to us and in bringing this matter to our attention.

Very truly yours,

/s/ Alexander Fernández
Trial Attorney
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Restatement (Second) of Trusts, Section 216(2) (1959) Comment k

k. Beneficiary's ignorance of facts and of his rights. Since the trustee is in a fiduciary relation to the beneficiary, he should inform the beneficiary of his rights and of the material facts affecting a transaction which is a deviation from the terms of the trust, so far as the trustee knows or should know these facts. The consent of the beneficiary does not preclude him from holding the trustee liable for a deviation from the terms of the trust, unless the beneficiary understands that the transaction is a deviation from the terms of the trust and that he is entitled to require the trustee to administer the trust according to its terms . . .

* * *

Q. (By Mr. Bachman) Mr. Traub, what would – regarding a loan for a plan participant, how much could a plan participant borrow?

A. Under the law, the maximum amount is $50,000 or one-half or 50 percent of his vested accrued benefit, whichever is the most.

Q. And I believe you testified previously that Mr. Olsen borrowed $50,000; is that correct?

A. That's correct.

Q. Are you aware of how much money Mr. Lonergan borrowed?

A. I believe – Is this in 1987?

Q. Yes, this is in 1987.

A. I think 7,500.

Q. Okay. Do you know why he didn't borrow more than $7,500?

A. Because he had an outstanding loan.

Q. And how much was that loan?

A. Forty-two five, if I recall.

Q. So therefore he couldn't borrow more than $7,500 in April of 1987?

A. That's correct.

Q. How much did Mr. Vercoe borrow?

A. I frankly don't recall.

Q. It has been admitted into evidence that he borrowed $11,950. That's from Exhibit 5. Does that refresh your memory?

A. I believe that's correct.

Q. It's also referred to in Exhibit Number 9. Do you know why Mr. Vercoe could not borrow any more money?

A. Presumably the 50 percent limitation came into effect.

* * *

T(88:5-25, 89:1-11)

Q. Mr. Dombrowski came to your office at FirsTier?

A. Yes, he did.

Q. Would this have been about March 27th or shortly after that in 1987?

A. March 27th or '8th probably.

Q. Who was present at that meeting?

A. Tom Moore and I and Mr. Dombrowski.

Q. What was said then?

A. Well, we discussed generally the documentation that we needed, and then we asked him why this was being done. And there was – His response at that time was that they were going to buy annuities for the participants with any excess being returned to the company.

* * *

T(53:14-25, 54:1)

Q. Did Mr. Moore ever inform you that they were in danger of defaulting?

A. No, he did not.

Q. What was your understanding then as to the financial condition of Land Paving at the time?

A. Only that they were experiencing some financial difficulties. I had no more knowledge of any specifics.

MR. BACHMAN: May I approach the witness, Your Honor?

THE COURT: You may.

Q. (By Mr. Bachman) Mr. Traub, do you recognize what I have placed in front of you?

A. It's my deposition.

Q. Okay. And you gave your deposition to me. Was counsel present for you at the time?

A. Yes.

Q. Okay. Mr. Traub, I'm going to read from the deposition – a portion of the deposition, and I want you to tell me if I read this correctly.

MR. RILEY: Will you give me page and –

MR. BACHMAN: Yes, page 114.

THE COURT: Is this by way of impeachment?

MR. BACHMAN: Yes.

MR. RILEY: Well, I think, Your Honor, it's improper impeachment, but I guess I have no objection.

THE COURT: All right.

Q. (By Mr. Bachman) Question: "Did he ever inform you that they were in danger of defaulting on any loans."

"Mr. Riley: By they do you mean Land Paving Company?"

"Mr. Bachman: Land Paving."

Answer: "He commented that there was – yes, a possibility of default."

Did you state that?

A. If it's in the deposition I did.

Q. Is that different than the testimony that you just gave in this court a minute ago?

A. It is.

Q. Did you wish to change your answer?

A. To the best of my recollection, I don't – I don't recall that Tom and I discussed the seriousness of it, but if I so testified at that time, then I will so testify now.

Q. So you wish to change your testimony that you knew that Land Paving Company was in danger of default?

A. Yes.

MR. RILEY: Your Honor, I'm going to object and move to strike the answer. He's now changing the statement. The deposition says that there was a possibility of default, not a danger of default.

THE COURT: All right. The answer is stricken without prejudice to you re-asking him the question.

Q. (By Mr. Bachman) Do you wish to change your answer then, Mr. Traub, that you were aware that there was a possibility that Land Paving would default on their loan?

A. That's correct.

* * *

T(69:1-25, 70:1-25, 71:1-5)